DOW THEORY LETTERS INC.

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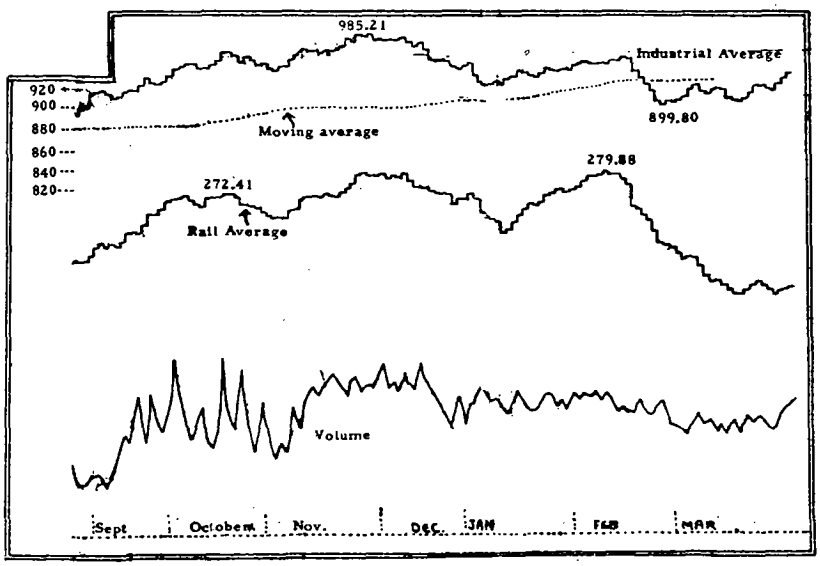
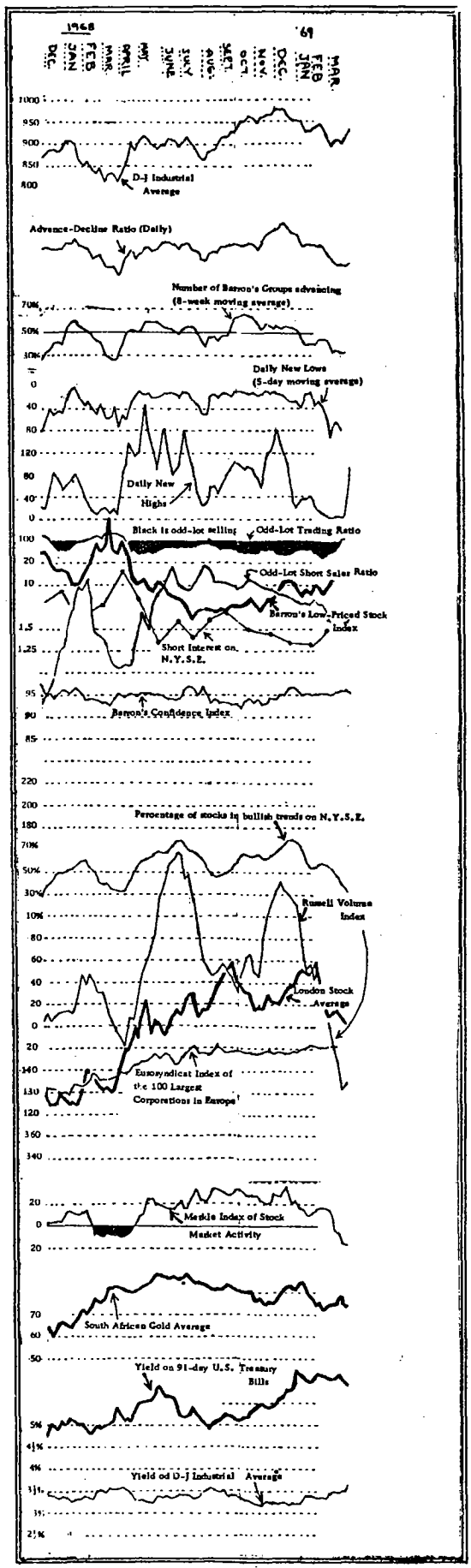
THE MARKET: Pity the poor stock market. It is undoubtedly in a quandary as to what to discount or what has already been discounted. Here we have a new President and a "new" Congress. All that Congress has done in the past nine weeks is raise its salary. The only thing the President has sent to Congress is a compromise electoral college reform bill (which he acknowledges is not the one he wants). The President has careened through Europe on an 8-day trip, the results of which no one is sure of. He has made numerous "frank" TV broadcasts, but he has not had anything earthshaking to announce.

The period of grace, the new President's "honeymoon," is about drawing to a close. With the war in Vietnam heating up again, the President is in the unenviable position of having threatened Hanoi with an "appropriate response." An appropriate response would serve to make it "Nixon's war," it would scuttle the Paris talks, and it would further harden the positions of the U.S. and Hanoi towards each other. Already, the new enemy offensive is delaying the promise of a return of U.S. troops, and any step-up in the war would throw the budget into a fantastic cocked-hat.

Things do not have to get any worse, in my opinion, to give the appearance of major trouble. If events simply continue on their present path, there will be trouble aplenty, and it is anyone's guess as to whether that trouble will start in Vietnam, on the gold front or on the business front.

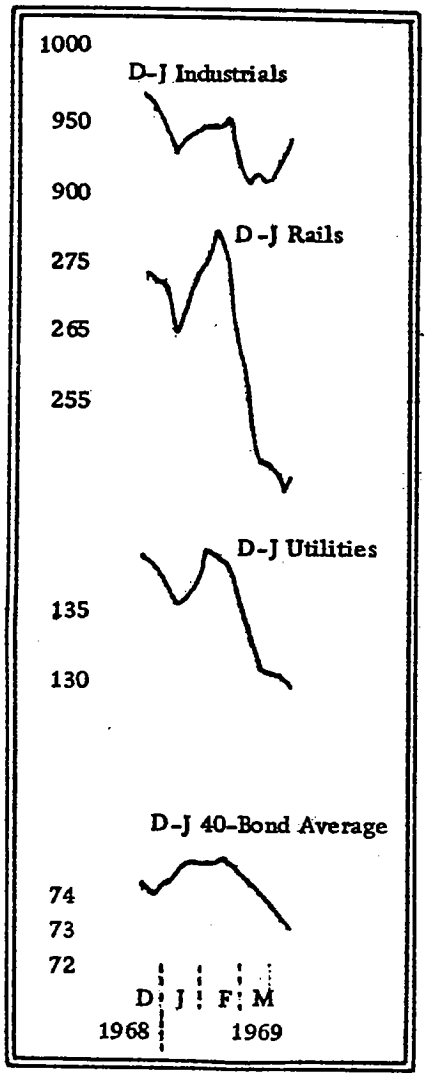
About every six months to a year some "new indicator" suddenly comes into fashion, and for some unexplainable reason (usually the indicator says what people want to hear) everyone talks about the new barometer. Currently, the fashionable indicator is the preponderance of investment advisory services which are bearish. Investors Intelligence has carried the statistics on leading investment services' bullish or bearish proclivities for years, but over the past two weeks I think I have read a dozen references to this study. The word is that two out of three services are now bearish, and since the majority of professional opinion is usually incorrect, this ratio is bullish for the market.




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (6-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield on D-J Industrial Average

Maybe so, but I distrust any indicator which becomes the fashion, and there is no doubt in my mind that the "number of services bearish" is now too widely followed. There is also the question of "how bearish is bearish," and I note that among the bearish services there are only three or four which I term really long-term bearish. The others vary from cautious to "we may have one more decline before the bottom," and this is not the type of bearishness which impresses me. Suffice it to say that I am not impressed by the "bullish or bearish investment service" study at this time. It's just too fashionable for me.

Turning to the action of the market itself, it might be well at this time to view the four D-J Averages, Industrials, Rails, Utilities and the 40-Bond Average (see chart). The chart covers the period of December, 1968 to the present on a weekly basis.



The overall low point for the market was struck on March 25. At that time the Dow Industrials were holding roughly 20 points above their extreme 1969 low closing of 899.80. The D-J Rail Average hit a new 1969 low of 241.44 on March 25. On the same day the Utility Average struck a 1969 low of 129.33. Finally, the 40-Bond Average sank to its lowest level since the early 1930's on March 25.

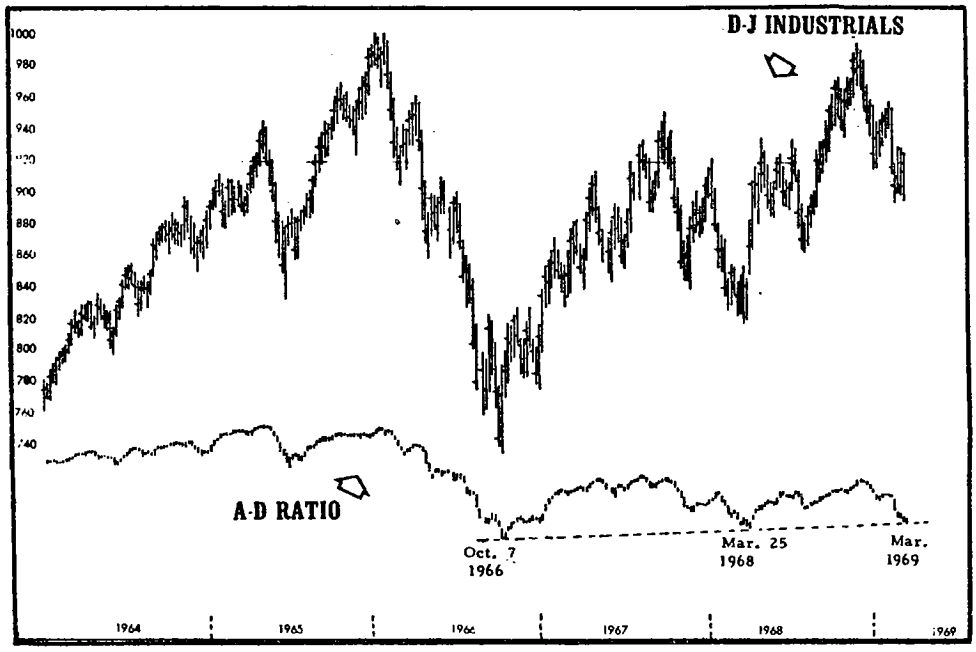
A rally followed with Industrials leading the way. Rails participated sluggishly in the rally, Utilities moved sideways and the 40-Bonds sank lower. It would be well from this point on to scrutinize the action of the Utility and Bond Averages. The reason is that in all past history, a refusal by Utilities and Bonds to rally with the Industrials has been a forerunner of trouble.

It should be remembered that any advance from here will serve to widen the bond-stock negative yield spread (see later section) to historic proportions, thus placing Wall Street on increasingly dangerous footing. I continue to view upside action from here as extremely dangerous. With the funds jumping in on a frantic, computerized basis, with the public following the market (on a "jump-in, jump-out" basis) as never before, with the monetary situation far from solved, with the yield situation more out-of-kilter than ever, an advance from this point is fraught with danger and could lead to a toppling over of the whole stock market and bond market structure.

The place to view all this is from the sidelines. The 1969 story is building up to a once-in-a-generation crescendo, and the flying pieces will ultimately shake the foundations of the financial world.

LONG-TERM: Popular opinion has it that inflation is good for the stock market. There have been few periods in history which produced more inflation than the period from 1964 to the present. Yet a glance at the accompanying chart casts doubt on the popular inflation thesis.

At the latest reading the D-J Industrial Average was in the neighborhood of its 1964 peak. The broad S & P 500 Average, by the way, is only about 10% above its 1964 high. Finally, the advance-decline ratio, following all the inflation since 1964, is within shooting distance of both its March, 1968 low and its October, 1966 low.



I have studied the relationship between the Dow and the A-D ratio for many years. During an extended decline, a non-confirmation (on the downside) by the A-D ratio or the Dow can be a signal for a major reversal, and this is exactly what occurred, for instance, during 1942 and 1949. On the other hand, during an extended advance a series of non-confirmations on the upside can mean a reversal to the downside.

Note on the chart that although the 1968 high on the Dow surpassed the 1967 high by a wide margin, the A-D ratio failed in 1968 to better its 1967 high. This was a potential danger signal for the advance. Since the rally produced an important non-confirmation of the upside, the next question was—what would occur on the decline?

As of this writing, the Dow has held well above its 1968 low of 825.13. But the A-D ratio has declined to within a narrow margin of the 1968 low. Since the 1967-68 advance failed to produce a confirmation between the Dow and the A-D ratio on the upside, it is entirely possible that if the A-D ratio now penetrates its 1968 low, the Dow will follow, thereby producing a confirmation on the downside.

A violation of the 1968 low on the A-D ratio would require a Dow penetration of 825.15 as a confirmation. This would mean a drop of almost 100 points from current Dow prices, and such a drop would of course take the A-D ratio below its 1966 low (at which time the Dow stood at 744.32).

Thus, the relationship between the Dow and the A-D ratio is now worth watching carefully. Any important decline from here is almost certain to violate a three-year downside range for the A-D ratio. This could set up a vacuum which could easily send the Dow tumbling to substantially lower levels. (Chart courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002).

COMING BATTLE: On March 13 the Commerce Dept. and the Securities & Exchange Commission issued a joint statement which represented a bombshell as far as Administration economists were concerned. The Statement said that industry plans to spend $73 billion on new plants and equipment in 1969, $9 billion more than last year. This is nearly twice as high as the 8% increase forecast by the Government only three months ago.

Actually, in the first quarter of 1969 business capital investment rose at a reputed (astounding) rate of 35%. If anything like this continues, the capital spending rate for 1969 will far exceed the new 14% rate suggested by the Commerce-S.E.C. tabulations.

Last week the authoritative Weekly Bond Buyer interviewed George Terbourg, top economist for the Machinery and Allied Products Inst. Terbourg, one of the intellectual leaders in the trade responded: "It is frightening. It is incredible. It is scandalous. There is no justification for spending of this size, except as a hedge against inflation. I am baffled; it is phenomenal. It is appalling because it means industry is paying no attention whatever to the restraints the Government is trying to put on the economy. They (industrial firms) are running wild on the assumption that all present Government efforts to get some stability into this economy will fail."

Louis Paradisio, a top Government economist commented, "The Federal Reserve Board has been put squarely behind the eight ball by this unexpected rise in capital spending.....Industry is betting that the Fed will chicken out rather than run the risk of another credit crunch like we had in 1966."

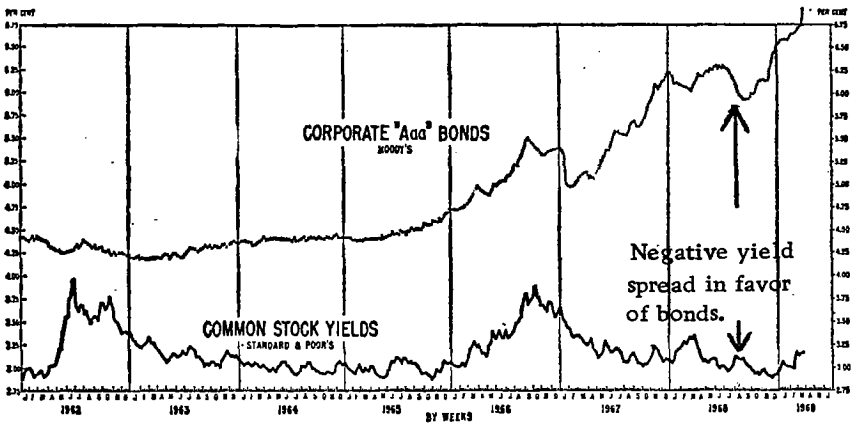
So there it is, the projections for 1969 spending by industry and the shocked response from "men in the know." The problem is looming up before the Administration like a battering ram. Will industry call their bluff again, will the Fed and the Government bow before politics and the pressure of the inflationists—or will the Fed and the Government finally take a stand?

Industry obviously does not believe that the Government will take a stand. The stock market is waiting to see whether the Government and the Fed will take a stand. The bond market has crumbled in anticipation of what has already happened, and it will crumble further if the Fed and the Government really do take a persistent anti-inflationary stand.

The first signal of a Government stand from here would be a boost in the discount rate, which is now an extraordinary 2% behind the new 7.5% prime rate. Since the 91-day Treasury bills are particularly sensitive to forthcoming changes in the prime rate, it is notable that the bills have dropped from a recent record high of 6.29% to the 6% area. This suggests that Wall Street money is still not anticipating a jump in the discount rate. At the rate inflation is still roaring ahead, however, I believe that the discount rate will be increased and that we have not yet seen the highs for the 91-day bills.

In all it is an unprecedented situation, and one which is sure to stand prominently in the history books. A subscriber, A. Minis (Minis & Co.) writes in a memorandum to clients, "There has not been a time in a century (and accurate figures do not go further back) that construction or industry expanded or the stock market rose optimistically when interest rates were as high as at present.....For those who are old enough to remember it, the times are reminiscent of the 1920's when great public utility empires were built by the process of buying up small units for stock, writing up their values and issuing new securities against them. Today the conglomerates are doing much the same thing by restating earnings to show what they would have earned last year if the new acquisitions had been owned that long."

The coming battle is going to reach its climax when the forces of deflation run into the pyramids built by inflation. In a bear market, all the dirty linen ultimately emerges for all to see, and that is the process I foresee during the next few years.



ANOTHER RECORD: Last week the yield spread between stocks and bonds widened to another historic record. The average yield on Moody's Aaa-rated corporate bonds rose to a new record of 6.95%. At the same time, the yield on the Standard & Poor 500 Stock Average held at a low 3.18%. This produced the new record negative yield spread of 3.77% in favor of bonds. Since then, it must be noted that the stock market has rallied strongly, almost insuring another record widening of the yield spread. From the standpoint of this study, the greater the negative yield spread in favor of bonds, the greater the danger of an ultimate disastrous long-term correction. A rallying stock market and a stationary or declining bond market serves only to widen the negative yield spread.

"THINKING," 1969-STYLE: I was particularly impressed by the story on the new head of Lykes Corp. in the April 1 issue of Forbes. Lykes (which is a profitable $100 million shipping outfit) is merging with Youngstown Sheet & Tube (which is a $1 billion steel company). In order to buy into Youngstown, Lykes has put itself in a position to invest $50 million in cash while borrowing up to $150 million. But it was the quote by Frank Nemec, head of Lykes, which interested me: "We feel there's a period of violent inflation coming, and therefore it makes sense to us to be most interested in natural resources. A natural resource company offers us the most protection against inflation, and any debt can be paid back in the future with inflated dollars." This statement would have sounded brilliant ten years ago. Somehow, it does not send me today.

WARNINGS — JANEWAY STYLE: Eliot Janeway notes that he has been reassured by the old adage that an erroding market is one that is insuring itself against panic. But he warns that the rule may be broken in coming weeks. "It's not a spring rally that is coming but an effort at a really big one, big enough to be very dangerous. It would have to be big to permit the funds to re-invest the huge cash reserves they have been building up. If three months later and 150 points higher on the Dow they get overboard again, at a time when distress credit conditions are even more acute than they already are, and after the banks have been entirely cleaned out of money, the ghetto won't be the only place in America where there will be a long hot summer." End of the Janeway warning, one which I entirely agree with.

CRISIS BAROMETER: French Capital continues its flight out of the country, and the French franc continues to sag. The Bank of France is daily buying massive amounts of French bank notes in Switzerland in an effort to prop up the franc. On the week ending March 13, the Bank of France announced that French reserves dropped $82.2 million. The following week France lost $42 million in reserves.

The Canadian prime rate at leading banks rose to 7.5%, in competing with the U.S. rate. Leading Swiss banks are raising their interest on time deposits as the scramble for money sweeps Europe. Rates on Eurodollars are now above 8%, as money-hungry American firms sop up all available funds.

The Deutsche Bundesbank raised its discount rate from 3.5% to 4%.

After dropping to $42.85, the price of gold again pushed over the $43 level, and this despite the supposed successful passing of the "strike test" by the French franc.

Despite Federal Reserve anti-inflation measures, U.S. industrial prices during the first two months of 1969 had their sharpest rise in a decade.

The U.S. suffered an all-time record trade deficit for a single month, losing $361 million in February. The fantastic trade deficit was blamed on the dock strike.

DOW'S THEORY: The original purpose of these reports was to offer subscribers the knowledge and ability to draw competent conclusions from the movement of the Averages, as interpreted under Dow's classical (and little understood) Theory. This might be a good time to turn to the study of the Averages again. The developing pattern of the Averages is certainly interesting.

I have drawn an arithmetic chart of the daily movement of the two Dow components since late February. Note that at the 899.90 Industrial low of February 25, the senior Average ended its decline. Rails, however, continued down to a March low of 241.44.

In the meantime, Industrials had been pushing up sharply forming a definite ascending zig-zag (marked A-B-C on chart). To date, Rails have failed to confirm. A Rail confirmation would require a Rail bettering of their March 20 peak of 245.71, and it remains to be seen whether the carriers can better the March 20 peak.

A persistent failure by Rails to better 245.71 would cast doubt on the validity of the March Rail and would indicate that the rally was meaningless from the standpoint of Dow's Theory. There is, of course, no time limit placed on Rails for a bettering of the 245.71 peak.